COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

)

Investigation by the Department of)

Telecommunications and Energy on its)

Motion into the Pricing and Procurement) D.T.E. 99-60

of Default Service Pursuant to)

G.L. c. 164, § 1B(d).)

)

REPLY COMMENTS OF PG&E CORPORATION

REGARDING PRICING AND PROCUREMENT OF DEFAULT SERVICE

I. INTRODUCTION

PG&E Corporation ("PG&E Corp." or "the Company") appreciates the opportunity to submit Reply Comments pursuant to the schedule contained in the Notice of Inquiry/Generic Proceeding into the Pricing and Procurement of Default Service issued by the Department of Telecommunications and Energy ("Department") on June 21, 1999 (the "NOI"). Upon review of the Initial Comments submitted to the Department, PG&E Corp. was impressed by the degree of consensus they exhibited on key theoretical issues pertaining to the supply of Default Service within the Massachusetts regulatory context.

Although filed by a relatively diverse set of government agencies, distribution companies, customer groups, competitive suppliers, and others, the strong consensus view was that Default Service pricing should send as accurate a price signal to customers as practicable. Although the details of the approaches suggested for doing so varied, the pricing objective was clear: price Default Service at its fully loaded cost to send customers accurate price signals.

The other important consensus point, in PG&E's view, is that the distribution company's role in offering a Default Service rate in Massachusetts is merely that of a conduit; the distribution company should neither benefit from nor be at risk for costs associated with providing Default Service. As a corollary matter, Default Service suppliers should be responsible for all aspects of balancing, with the distribution company having no role in that function whatsoever. Management of volumetric risk should be the responsibility solely of the Default Service supplier, not the distribution company.

The remainder of these Reply Comments respond to particular issues raised by several of the other commenters.

II. FREQUENCY AND STRUCTURE OF SOLICITATIONS

Many of the commenters endorsed the idea of pricing Default Service as close to the full cost of serving the retail market as practicable.[(1)] Not only is that approach consistent with the Restructuring Act, but it is also necessary to complement, not inhibit, the development of a more competitive retail market. Many commenters concluded that procuring power every six to twelve months would be adequate to accomplish the goal of having Default Service prices reflect market prices. Other commenters, however, including PG&E Corp., suggested procurement methods which would produce much more accurate signals. For example, PG&E Corp. recommended that the procurement for large C&I customers be done quarterly.[(2)] As a further refinement, other commenters suggested that bids be submitted by rate class to more accurately reflect the cost of serving customers with different load profiles.[(3)] PG&E Corp. endorses that approach as well, provided that the solicitations are conducted at least quarterly for larger C&I rate classes and at least annually for residential and small commercial rate classes. PG&E Corp. acknowledges that more frequent solicitations will increase customer acquisition costs for Default Service suppliers. To the extent that Default Service customer acquisition costs will approximate or equal the customer acquisition costs of competitive suppliers, Default Service will not be priced below market. From a retail market development perspective, that is an appropriate outcome.

III. VARIABLE RATE OPTION

In addition, PG&E Corp. agrees with several commenters that customers with hourly meters should have access to a Default Service rate option that varies hourly.[(4)] For customers without such meters, PG&E Corp. urges the Department to require that a variable Default Service rate option be made available to all customers. Although the statute and the Department's regulations allow for a rate option with a fixed rate for up to six months, it does not preclude a variable rate option. In order to supply such an option, Default Service bidders would price their bids at "market price plus an adder." The distribution company would select from among those bids based upon the lowest adders requested. The benefit of requiring this option is that customers opting for it would be able to experience the costs and savings associated with market prices and would then be able to compare competitive supply options relative to the variable Default Service rate. Moreover, this rate option would facilitate a demand response in the physical market which is necessary to better manage peak demand operating conditions in the New England region. This recommendation is premised on the assumption, however, that the distribution company will have no role in balancing and that all volumetric risk and load profile risk will be managed by the Default Service supplier. Absent that assumption, there would be no benefit to offering a variable rate.

The fixed, variable and hourly rate options are the only options which PG&E Corp. recommends be available under Default Service. Customers seeking other types of value-added options or "green" options should exercise those choices in the competitive market. By so doing, customers will challenge and shape that market, and encourage the type of innovation which only competitive markets can produce.

IV. BIDDING IN BLOCKS

Several commenters suggested that multiple Default Service suppliers be encouraged by dividing the Default Service load into blocks.[(5)] PG&E Corp. takes no position on whether multiple Default Service suppliers should be a requirement within each franchise area. However, in the event that there are multiple suppliers, increases or decreases in Default Service load should be apportioned to all suppliers. No supplier should be guaranteed a firm block of load to supply for a specific term; Default Service suppliers should face the same type of volumetric risk that competitive suppliers face.

V. TIMING OF INITIATION OF COMPETITIVE PROCUREMENTS

A small minority of commenters suggested that competitive procurement of Default Service should be deferred or delayed past the first quarter of 2000. Given the value to the retail market of having Default Service competitively procured and properly priced, PG&E Corp. encourages the Department to order competitive procurements to begin as soon as practicable, and not delay beyond the first quarter of 2000.

VI. STATEWIDE SOLICITATION OPTION

PG&E Corp. does not favor the possibility of a statewide solicitation for Default Service supply for two reasons. First, it creates the possibility of having one supplier serving a substantial percentage of the total retail load in the Commonwealth. The economies of scale inherent in that result would place competitive suppliers at an unhealthy disadvantage. That degree of market concentration in the hands of a single supplier could also trigger antitrust concerns. Second, given that the cost of supplying power in different areas of the Commonwealth can vary widely, a single Default Service supplier for the Commonwealth could average its costs on a statewide basis, making it nearly impossible for competitive suppliers to compete for load in high cost areas. For these reasons, PG&E Corp. does not favor a statewide aggregation of Default Service load.

VII. ASSIGNMENT OF CUSTOMERS TO SUPPLIERS

Several commenters suggested that at some point in the future, customers should be assigned to third party suppliers of Default Service as a means for terminating the distribution company's role in arranging for Default Service. PG&E Corp. does not support that approach. Markets flourish from customers exercising choice, not from customers being forced to take service from an entity not of their choosing. In PG&E Corp.'s view, the detrimental impact on restructuring from customer resentment from having been involuntarily assigned is likely to far outweigh the benefit of eliminating the distribution company as the arranger of Default Service.

VIII. CONCLUSION

As the Company emphasized in its Initial Comments, Default Service has tremendous potential to inhibit the development of a competitive retail market. It must be priced to reflect all commodity, load managing and customer care costs. In its Initial Comments, the Company outlined in detail what costs must be included. Should the Department determine that hearings on this matter would be

beneficial, representatives of PG&E Corp. would be pleased to participate and provide any necessary clarifications of positions taken in its Initial and Reply Comments.

Respectfully submitted,

PG&E CORPORATION

By its attorneys,

Mary Beth Gentleman

Richard W. Benka

Foley, Hoag & Eliot LLP

One Post Office Square

Boston, MA 02109

(617) 832-1000

Peter E. Meier

Chief Counsel, Northeast Region

PG&E Generating Company

One Bowdoin Square

Boston, MA 02114

(617) 788-3000

Dated: July 28, 1999

1. See, e.g., Initial Comments of Associated Industries of Massachusetts, at pp. 1-2; Attorney General, at pp. 2, 3-5; Boston Edison-Cambridge Electric-Commonwealth Electric ("BECo/COMM"), at pp. 3-4 & n.1, p. 6; Competitive Power Coalition, at Questions 2/3, 6; Division of Energy Resources, at pp. 14-15; Eastern Edison, at pp. 4-5; Electric Power Supply Association, at "Price to Beat," pp. 1-2; Fitchburg Gas & Electric, at Questions DTE-1-2, 1-3; IRATE, Inc., at p. 2; Competitive Retail Market Participants, at Executive Summary, p. 2, at Text, pp. 1-3, 12-19; PG&E Corp., at pp. 5-6, 7-8; Sithe New England, at pp. 3-4; Western Massachusetts Industrial Consumers Group ("WMICG"), at p. 1, at Appendix A, Question 1.

2. Initial Comments of PG&E Corp. at pp. 4-5, 9.

3. Initial Comments of Competitive Retail Market Participants, at pp. 20, 22-23; WMICG, at p. 2, at Appendix A, Question 2. See also Initial Comments of Competitive Power Coalition, at Question 6.

4. Initial Comments of WMICG, at p. 2, at Appendix A, Question 2. See also Initial Comments of Competitive Retail Market Participants, at Appendix B, Question 5.

5. Initial Comments of Associated Industries of Massachusetts, at p. 3; Electric Power Supply Association, at "Provider of Last Resort Service," p. 2; Competitive Retail Market Participants, at Text, p. 22. See also Initial Comments of Division of Energy Resources, at p. 19 (first competitive solicitation only).